IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA

TIG INSURANCE CO.	:	CIVIL ACTION
	:	
v.	:	
	:	
NOBEL LEARNING COMMUNITIES, INC., ET AL.	:	NO. 01-4708
	:	
	:	

MEMORANDUM

Giles, C.J. June 18, 2002

I. INTRODUCTION

TIG Insurance ("TIG") filed this Complaint for Declaratory Judgment against its insured, Nobel Learning Communities, Inc. ("Nobel") and the underlying claimants, Dr. Deborah Levy ("Dr. Levy"), Dr. Levy's company, Development Resource Center ("DRC"), Dr. Levy's daughter, Emily Levy ("Emily") and LD Learning.com, Inc. ("LD Learning") of which Emily was the sole shareholder. TIG seeks a declaration that under the Nobel policy, it had no duty to defend a counterclaim asserted against Nobel by Dr. Levy, DRC, Ms. Levy and LD Learning (collectively "the counterclaimants") after Nobel sued them in the U.S. District Court for the Southern District of Florida in Nobel Learning Communities, Inc. and Paladin Academy, LLC v. Development Resource Center, Dr. Deborah Levy, LD Learning.com, Inc. and Emily Levy, No. 00-CV-3286 (the "Florida action"). TIG also seeks a declaration that it has no duty to reimburse Nobel for a series of expenses related to Nobel's settlement of the underlying action.

II. FACTUAL BACKGROUND

TIG issued Policy No. T7X38839398 (the "Policy") to Nobel for the period June 28, 2000 through April 1, 2001. In the Policy, TIG promised to defend Nobel and its other named

insureds, including Paladin Academy, Inc., ("Paladin") against all claims of "personal and advertising injury" arising from of, inter alia, "infringement upon another's copyright." Exhibit A to Complaint, at Commercial General Liability Broadened Coverage Form, ¶ I.g.

Prior to June 1998, DRC owned and operated four schools for learning disabled students in Florida. Dr. Levy was sole shareholder and executive director of DRC and her daughter, Emily, was an employee. In June 1998, DRC sold its assets to Nobel (under its former name, Nobel Education Dynamics, Inc.) and the parties formed Nobel Learning Solutions, LLC (later named Paladin Academy). Prior to the transfer of assets, Dr. Levy had developed various items of intellectual property at DRC including *The Stop and Go Multi-Sensory Phonics Program, The Stoplight Number Book, the Auditory Memory Books I and II, the Auditory Motor Teacher's Guide, the Auditory Motor Student Guide, the New Image Book.*

Following the transfer of assets, Nobel employed Dr. Levy as Paladin's Director of Education in which capacity she developed special education materials entitled *Visual Tracking Numbers I* and *II*, and *Visual Tracking Letters I* and *II.* Thereafter, Dr. Levy's relationship with Nobel and Paladin soured. Employer and employee differed over the rights and scope of their relationship and, in particular, about the use of certain copyrights that Nobel asserted Dr. Levy had assigned to it pursuant to the asset purchase agreement.

On September 1, 2000, Nobel and Paladin filed the aforementioned Complaint for Declaratory Judgment of Copyright Ownership seeking a declaration of Nobel and Paladin's rights. The aforedescribed counterclaimants filed an Amended Counterclaim on October 20, 2001. There, they alleged, inter alia, willful copyright infringement. Nobel and Paladin submitted a demand for coverage on December 1, 2001 to TIG which declined to defend Nobel

and Paladin against any of the claims set forth in the counterclaim.

All parties to the Florida action then entered into settlement negotiations. Nobel gave TIG written notice of the pendency of the settlement discussions, but TIG again declined to provide a defense. The Florida action was marked settled and discontinued by stipulation on May 14, 2001. In exchange for the release of claims of all copyright infringement, Nobel paid LD Learning $185,000. In May 2001, Nobel and Paladin demanded that TIG indemnify them for the settlement payment as well as for $315,000 in attorney's fees incurred in connection with the Florida action. On May 29, 2001, TIG's counsel wrote to Nobel's counsel denying any obligation to Nobel under the policy. TIG now asks this court to declare that it had, and has, no duty to reimburse Nobel, or any other party, for any sums, attorney's fees or costs allegedly incurred by Nobel in prosecuting, defending or settling the Florida action.

In the present action, Nobel has filed a counterclaim seeking declaratory judgment as to TIG's liability for Nobel's defense, settlement and prosecution costs in the Florida action, as well as the costs of defending against TIG's complaint for declaratory judgment in its favor. The movants seek judgment on the pleadings.

For the reasons that follow, TIG's request for declaratory judgment is granted, in part and denied in part; and, Nobel's counterclaim for declaratory judgment is also granted, in part and denied in part.

A. The Nobel Policy

The Nobel Policy contains the following relevant provisions:

SECTION I - COVERAGES

1. Insuring Agreement

a. We will pay those sums that the insured becomes legally obligated to pay as damages because of "bodily injury" or "property damage" to which this insurance applies. (General Policy Section I. Coverages A. 1.a.)

* * *

b. This insurance applies to "bodily injury" and "property damage" only if:

(1) The "bodily injury" or "property damage" is caused by an "occurrence." (General Policy Section I. Coverages A. 1.b(1).)

2. Exclusions

This insurance does not apply to:

a. Expected or Intended Injury

"Bodily injury" or "property damage" expected or intended from the standpoint of the insured. (General Policy Section I. Coverages A. 2.a.)

* * *

e. Employer's Liability

"Bodily injury" to:

(1) An "employee" of the insured arising out of and in the course of :

(a) Employment by the insured; or

(b) Performing duties related to the conduct of the insured's business;(General Policy Section I. Coverages A. 2.e.(1)(a-b)).

* * *

The exclusion applies:

(1) Whether the insured may be liable as an employer or in any other capacity;

* * *

j. Damage to Property

"Property damage" to:

(4) Personal property in the care, custody or control of the insured;

* * *

SECTION V - DEFINITIONS

1. "Advertisement" means a notice that is broadcast or published to the general public or specific market segments about your goods, products or services for the purpose of attracting customers or supporters. (General Policy Section V. 1.)

* * *

3. "Bodily injury" means bodily injury, sickness or disease sustained by a person. This includes mental anguish, mental shock, fright, humiliation, emotional distress or death resulting from bodily injury, sickness or disease. (General Policy Section V. 3.)

* * *

13. "Occurrence" means an accident, including continuous or repeated exposure to substantially the same general harmful conditions. (General Policy Section V. 13.)

14. "Personal and advertising injury" means injury, including consequential "bodily injury" arising out of one or more of the following offenses:

* * *

g. Infringing upon another's copyright, trade dress or slogan in your "advertisement."

* * *

17. "Property damage" means:

a. Physical injury to tangible property, including all resulting loss of use of that property. All such loss of use shall be deemed to occur at the time of the physical injury that caused it; or

b. Loss of use of tangible property that is not physically injured. All such loss of use shall be deemed to occur at the time of the "occurrence" that caused it.

* * *

EMPLOYMENT - RELATED PRACTICES EXCLUSION

This endosement modifies insurance provided under the following:

COMMERCIAL GENERAL LIABILITY PART

A. The following exclusion is added to paragraph 2.,
Exclusions of Section I - Coverage A - Bodily Injury And Property Damage Liability:

B. The following exclusion is added to paragraph 2.,
Exclusions of Section I - Coverage B - Personal and Advertising Injury Liability:

The insurance does not apply to:

"Bodily injury" to

(1) A person arising out of any:

(a) Refusal to employ that person;

(b) Termination of the person's employment; or

(c) Employment-related practices, policies, acts or omissions. Such as coercion, demotion, evaluation, reassignment, discipline, defamation, harassment, humiliation or discrimination directed at that person; or

(2) The spouse, child, parent, brother or sister of that person as a consequence of "bodily injury" to the person at whom any of the employment-related practices described in Paragraphs (a), (b), or (c) above is directed.

This exclusion applies:

(1) Whether the insured may be liable as an employer or in any other capacity;

and

(2) To any obligation to share damages with or repay someone else who must pay damages because of the injury.

COVERAGE B - PERSONAL AND ADVERTISING INJURY LIABILITY

1. Insuring Agreement

a. We will pay those sums that the insured becomes legally obligated to pay as damages because of "personal and advertising injury" to which this insurance applies.

* * *

2. Exclusions

This insurance does not apply to:

a. "Personal and advertising injury"

(1) Caused by or at the direction of the insured with the knowledge that the act would violate the rights of another and would inflict "personal and advertising injury."

(2) Arising out of publication of material, including but not limited to, oral, written, televised, videotaped or electronically transmitted publication of material, if done at the direction of the insured with knowledge of its falsity.

(3) Arising out of publication of material, including but not limited to, oral, written, televised, videotaped or electronically transmitted publication of material, whose first publication took place before the beginning of the policy period.

* * *

(6) Arising out of a breach of contract except an implied contract to use another's advertising idea in your "advertisement";

*** * ***

B. The Counterclaim in the Underlying Florida Action

The Amended Counterclaim in the Florida action pled a cause of action against Nobel and Paladin entitled "Copyright Infringement." Exhibit C to First Amended Complaint for Declaratory Judgment, at Count XII. In pertinent part, the counterclaim stated:

> 134. This is an action against Paladin for copyright infringement which arises under 17 U.S.C. § 501 et seq. And is therefore within the exclusive jurisdiction of this court.
>
> 135. LD Learning is the owner of the following copyright registrations, copies of which are attached hereto as Composite Exhibit "8" (the "Copyrights"):
>
> A. Auditory Motor; TX 5-045-369;
>
> B. Auditory Motor Teacher's Manual; TX 5-040-101;

C. Auditory Motor Student Guide; TX 5-040-102;
D. Visual Tracking Letters II; TX 5-040-100;

136. The copyrights are valid and in full force in the United States.

137. Within the last three years, Paladin, within this judicial district and elsewhere in the United States, has infringed the Copyrights by, inter alia, making copies of the entire works without the permission or consent of LD Learning.

138. The infringement of the Copyrights occurred notwithstanding Paladin's knowledge that the Copyrights were owned by LD Learning, and the infringement was therefore willful.

Id. at ¶¶ 134-38.

III. DISCUSSION

The Declaratory Judgment Act, 28 U.S.C. § 2201 empowers federal courts to grant declaratory relief. State Auto Ins. Co. v. Summy, 234 F.3d 131, 133 (3d Cir.2000). The purpose of a declaratory judgment procedure is to furnish an expeditious remedy for the settlement of claims which indicate imminent and inevitable litigation. Aetna Cas. and Sur. Co. v. Roe, 650 A.2d 94, 99 (Pa. Super. 1994) (citing Eureka Casualty Co. v. Henderson, 92 A.2d 551, 553 (Pa. 1952)). "Judgment on the pleadings is proper only where the pleadings [evince] that there are no material facts in dispute such that a trial by jury would be unnecessary." Pennsylvania Financial Responsibility Assigned Claims Plan v. English, 664 A.2d 84, 86 (Pa.1995).

The determination of coverage under an insurance policy is a question of law to be decided by the court. PECO Energy Co. v. Boden, 64 F.3d 852, 855 (3d Cir.1995); Madison Const. Co. v. Harleysville Mut. Ins. Co., 735 A.2d 100 (Pa. 1999). In order to determine whether a claim may potentially come within the coverage of an insurance policy, the court must first ascertain the scope of the insurance coverage and then analyze the allegations in the complaint. Britamco Underwriters, Inc. v. Weiner, 636 A.2d 649, 651 (Pa. Super. 1994). The parties agree that Pennsylvania law governs the interpretation of the insurance contract.

A. Insurance Contracts

The goal of interpreting an insurance contract is to "ascertain the intent of the parties as manifested by the language of the written instrument." Madison, 735 A.2d at 106. Where a provision of a policy is ambiguous, the policy provision is to be construed in favor of the insured and against the insurer. Id. Where, however, the language of the contract is clear and unambiguous, a court is required to give effect to that language. Id. (citing Gene & Harvey Builders v. Pennsylvania Mfrs. Ass'n, 517 A.2d 910, 913 (Pa. 1986) (quoting Standard Venetian Blind Co. v. American Empire Ins. Co., 469 A.2d 563, 566 (Pa. 1983)).

Contractual language is ambiguous "if it is reasonably susceptible of different constructions and capable of being understood in more than one sense." Hutchison v. Sunbeam Coal Co., 519 A.2d 385, 390 (Pa. 1986). Courts must determine ambiguity or lack thereof "by reference to a particular set of facts," Madison, 735 A.2d at 107, but courts should not "distort the meaning of the language or resort to a strained contrivance in order to find an ambiguity." Id. at 106 (citing Steuart v. McChesney, 444 A.2d 659, 663 (Pa. 1982)). Thus, "the polestar of [the] inquiry" is the language of the insurance policy. Id.

B. Duty to Defend

A carrier's duty to defend an insured in a suit brought by a third party depends upon a determination of whether the third party's complaint triggers coverage. Mutual Ben. Ins. Co. v. Haver, 725 A.2d 743 (Pa. 1999) (citing General Accident Insurance Co. of America v. Allen, 692 A.2d 1089, 1095 (Pa.1997); Wilson v. Maryland Casualty Co., 105 A.2d 304, 307 (Pa. 1954)). The averments contained in the underlying complaint must be "liberally construed with all doubts as to whether the claims may fall within the policy coverage to be resolved in favor of the

insured." Roman Mosaic and Tile Co. v. Aetna Cas. and Sur. Co., 704 A.2d 665, 669 (Pa. Super. 1997) (citing Cadwallader v. New Amsterdam Cas. Co., 152 A.2d 484 (Pa.1959)). "As long as the complaint comprehends an injury which may be within the scope of the policy, the company must defend the insured until the insurer can confine the claim to a recovery that the policy does not cover." United Services Auto. Ass'n v. Elitzky, 517 A.2d 982, 985 (Pa. Super. 1986); see Forum Ins. Co. v. Allied Sec., Inc., 866 F.2d 80 (3d Cir. 1989); Biborosch v. Transamerica Ins. Co.,, 603 A.2d 1050 (Pa. 1992); Cadwallader, 152 A.2d at 589. Stated differently, if coverage depends upon the existence of facts yet to be determined, the insurer is obliged to provide a defense "until such time as those facts are determined, and the claim is narrowed to one patently outside of coverage." C. Raymond Davis & Sons, Inc. v. Liberty Mut. Ins. Co., 467 F. Supp. 17, 19 (E.D. Pa. 1979). This rule applies even where the suit is "groundless, false, or fraudulent" and has "no basis in fact." Britamco, 636 A.2d at 651.

The Pennsylvania Supreme Court has held that the particular cause of action that a complainant pleads is not determinative of whether coverage has been triggered. Haver, 725 A.2d at 746. Instead, a court must examine the factual allegations contained in the complaint. Id. (citing Scopel v. Donegal Mutual Insurance Co., 698 A.2d 602 (Pa. Super.1997); Aetna Casualty and Surety Co. v. Roe, 650 A.2d 94, 98 (Pa. Super. 1994)). "The cases are legion which hold that the obligation to defend "is triggered if the underlying complaint avers any facts that potentially could support a recovery under the policy." USX Corp. v. Adriatic Insurance Co., 99 F. Supp.2d 593, 611 (W.D. Pa. 2000); see e.g., Visiting Nurse Ass'n of Greater Philadelphia v. St. Paul Fire & Marine Ins. Co., 65 F.3d 1097, 1100 (3d Cir.1995); Kiewit Eastern Co. Inc. v. L & R Constr. Co., Inc., 44 F.3d 1194, 1205 (3d Cir.1995); Rector, Wardens and Vestryman of St.

Peter's Church in City of Philadelphia v. American National Fire Ins. Co., 2002 WL 59333, *4 (E.D. Pa. 2002) (quoting CAT Internet Sys., Inc. v. Providence Washington Ins., 153 F.Supp.2d 755, 759 (E.D. Pa. 2001)).

C. Duty to Indemnify

"While an insurer must defend its insured if the complaint alleges conduct that *potentially* falls within the scope of the policy, it must indemnify its insured only if liability is found for conduct that *actually* falls within the scope of the policy." Winner Intern. Corp. v. Continental Cas. Co., 889 F.Supp. 809 (W.D. Pa. 1994); Allstate Ins. Co. v. Brown, 834 F. Supp. 854, 857 (E.D. Pa.1993). Thus, the duty to indemnify is narrower than the duty to defend and to pay the costs of defense. Forum Ins., 866 F.2d at 84-85; J.H. France Refractories v. Allstate, 626 A.2d 502, 510 (Pa. 1993); Biborosch, 603 A.2d at 1052. Since an insurer's duty to defend requires the insurer to provide a defense and pay defense costs of a claim that might ultimately fall outside the coverage of the policy, Forum Ins., 866 F.2d at 84-85; Biborosch, 603 A.2d at 1052, an insurer may have an obligation to defend although no obligation to indemnify. The Frog, Switch & Manufacturing Co., Inc. v. The Travelers Ins. Co., 193 F.3d 742, 746 (3d Cir.1999); Gedeon v. State Farm Mut. Auto. Ins. Co., 188 A.2d 320 (Pa. 1963); Heffernan & Co. v. Hartford Ins. Co. of America, 614 A.2d 295 (Pa. Super. 1992).

1. TIG Insurance: Count I

In Count I, TIG seeks declaratory judgment against all defendants on the grounds that there is no coverage under Part A of the TIG policy because 1) the allegation of willful copyright infringement in the counterclaim to the Florida action does not constitute either "bodily injury" or "property damage" as those terms are described in the policy; 2) the allegations do not

constitute an “occurrence” as the term is defined in the policy; 3) there is an applicable exclusion for “bodily injury” or “property damage” which is “expected or intended by the insured”; 4) there is an applicable exclusion to “property damage” for “personal property in the care, custody or control of the insured”; and, 5) there is an applicable exclusion for “bodily injury” to an employee, which applies whether the insured may be liable as an employer or in any other capacity.

The TIG policy states: “‘Bodily injury’ means bodily injury, sickness or disease sustained by a person. This includes mental anguish, mental shock, fright, humiliation, emotional distress or death resulting from bodily injury, sickness or disease.” (General Policy Section V. 3.). Clearly, copyright infringement does not constitute a “bodily injury” as the term is defined in the policy. Thus, the counterclaim is not within the coverage of that provision.

The TIG policy defines “[p]roperty damage” as either a) “[p]hysical injury to tangible property, including all resulting loss of use of that property,” with “[a]ll such loss of use . . . deemed to occur at the time of the physical injury that caused it; or, b) “[l]oss of use of tangible property that is not physically injured,” with “[a]ll such loss of use . . . deemed to occur at the time of the “occurrence” that caused it. The property damage must be the result of an “occurrence,” defined as “an accident, including continuous or repeated exposure to substantially the same general harmful conditions.” (General Policy Section V. 13.)

On its face, the TIG policy requires that some item of tangible property must exist. Under Pennsylvania law, where a liability policy's definition of "property damage" is qualified by the term “tangible . . . . [t]he definition contemplates only property damage which is physical, capable of being touched and objectively perceivable and not intangible property, such as

property that represents value but has no intrinsic marketable value of its own (i.e. stock, investments, copyrights, promissory notes)." U.S. Fidelity & Guar. Co. v. Barron Industries, Inc., 809 F. Supp. 355, 360 (M.D. Pa. 1992); International Ins. Co. v. St. Paul Fire & Marine Ins. Co. 1988 WL 113360, *6 (E.D. Pa. 1988) (quoting Gulf Ins. Co. v. L.A.Effects Group, Inc., 827 F.2d 574, 577-78 (9th Cir. 1987) ("Tangible property" is property that has "physical substance apparent to the senses" or "that is capable of being felt or touched."). Although the "typical 'loss of use' clause . . . reflect[s] coverage for loss of use of tangible property which has not been physically injured or destroyed," there is a "basic expectation that the loss of use must be causally related to damage to tangible property." USX Corp., 99 F. Supp.2d at 615 (citing Lucker Mfg., A Unit of Amclyde Engineered Products, Inc. v. Home Ins. Co., 23 F.3d 808, 820-21 (3d Cir. 1994) (loss of use of the design of a component part, an intangible thing, was not covered property damage)). Copyrights are intangible items of intellectual property. Therefore, under the policy's clear and unambiguous definition of "property damage," a claim for copyright infringement is not covered.

Having determined that the counterclaim alleges neither "bodily injury" nor "property damage," the court will not address the remaining arguments in Count I pertaining to exclusions thereunder.

2. TIG Insurance: Count II

In Count II, TIG seeks declaratory judgment against all defendants and, in support, argues thatthere is no coverage under Part B of the Nobel policy because the allegations in the counterclaim do not constitute "personal injury and advertising injury" as those terms are defined. TIG further asserts that there are specific applicable exclusions for personal and advertising injury 1) which is caused by or at the direction of the insured with the knowledge that

the act would violate the rights of another and cause personal and advertising injury; 2) whose first publication takes place before the beginning of the policy period; or, 3) which arises out of a breach of contract.

a. Copyright Infringement

TIG argues that the relevant injury alleged against Nobel in the counterclaim is willful copyright infringement and that such is subject to the policy exclusion of "injury which is caused by or at the direction of the insured with the knowledge that the act would violate the rights of another and cause personal and advertising injury."

In determining whether the complaint states a cause of action for a covered claim, a Pennsylvania court is confined to the four corners of the underlying complaint. I.C.D. Indus., Inc. v. Federal Ins. Co., 879 F. Supp. 480 (E.D. Pa. 1995); Gene's Restaurant, Inc. v. Nationwide Ins. Co., 548 A.2d 246 (Pa. 1988). In Gene's Restaurant, the insured was sued by a patron who specifically alleged that she had been willfully and maliciously assaulted by another patron who "str[uck] her with fists and with great force and violence repeatedly shook, cast and threw the said plaintiff to the ground." Gene's Restaurant, 548 A.2d at 247. Applying the four corners rule, the Supreme Court held that the insurer was not required to provide coverage because torts based on the type of intentional conduct alleged in the complaint were not covered. Id.

However, the third circuit has recognized that the holding in Gene's Restaurant may not apply where the complaint contains alternative theories of recovery alleging both intentional and negligent conduct. See Nationwide Mut. Fire Ins. Co. of Columbus v. Pipher, 140 F.3d 222 (3d Cir. 1998). There, the federal appeals court viewed the Gene's Restaurant holding as a narrow one. It explained that "[b]ecause the complaint alleged solely intentional acts and contained no

allegations of negligence on the part of its insured, the Gene's Restaurant court came to the unremarkable conclusion that an intentional tort was not an accident and thus not a covered occurrence under the policy." Id. (citing General Accident Ins. Co. of America v. Allen, 692 A.2d 1089, 1094 (Pa. 1997); Gene's Restaurant, 548 A.2d at 246; Wilson v. Maryland Cas. Co.,105 A.2d 304, 307 (Pa. 1954)). Pipher concluded that where a complaint alleges both intentional and negligent conduct, the insurer has a duty to defend.

Similarly, in Safeguard Scientifics v. Liberty Mutual Ins. Co., 766 F. Supp. 324 (E.D. Pa.1991), rev'd in part on other grnds., 961 F.2d 209 (3d Cir.1992 (table)),[1] the court found that where the complaint stated a claim for intentional defamation that did not fall within the scope of the insurance policy, it was reasonable to believe that the claim could potentially be for reckless or negligent slander, and it held that the insurer was required to provide coverage. Id. at 330;see also Britamco Underwriters v. Emerald Abstract Co., 855 F. Supp. 793, 797-99 (E.D. Pa. 1994) (Katz, J.) (finding that complaint alleging breach of fiduciary duty could be reasonably amended to include a claim for negligence). Safeguard Scientifics recognized the tension between the requirement that a court confine itself to the four corners of the complaint, and caselaw establishing that where there is a potentially covered claim, the insurer's refusal to defend at the outset is a decision it makes at its own peril. Id. at 330 (citing Cadwallader,152 A.2d at 488). The district court predicted that the Supreme Court of Pennsylvania would reconcile these concepts by requiring an insurer to provide a defense where a complaint could be "reasonably amended" to state a compensable claim. Id. at 330;see also Britamco Underwriters, 855 F. Supp.

[1] In a non-precedential, unpublished opinion, the third circuit reversed Safeguard Scientifics on the denial of pre-notice attorney's fees, only, and affirmed in all other respects.

at 798-99 (employing same approach). "Pennsylvania intermediate appellate courts have reconciled the apparently contradictory coverage principles by allowing coverage for claims that 'potentially fall' within the scope of coverage, but only insofar as those 'potential' claims are grounded in the complaint itself." I.C.D. Indus., Inc. v. Federal Ins. Co., 879 F. Supp. 480, 488 (E.D. Pa. 1995) (citing Aetna Casualty & Sur. Co. v. Roe, 650 A.2d 94, 99 (Pa. Super.1994) ("The insurer is obligated to defend if the factual allegations of the complaint on its face comprehend an injury which is actually or potentially within the scope of the policy"); Humphrey's v. Niagara Fire Ins. Co., 590 A.2d 1267, 1271 (Pa. Super. 1991) ("The obligation to defend arises whenever the underlying complaint . . . potentially may come within the coverage of the policy."); American States Ins. Co. v. Maryland Casualty Co., 628 A.2d 880 (Pa. Super. 1993) (same) (citing, inter alia, Cadwallader, 152 A.2d at 484)).

In 1999, the third circuit clarified that "Safeguard Scientific's formulation of the duty to defend applies in a particular situation --when the underlying complaint alleges intentional action, but negligent or reckless action would suffice to make the insured's conduct actionable– and is merely a way of saying that such a complaint "potentially" comes within the insurance coverage." Frog, Switch & Mfg. Co., Inc. v. Travelers Ins. Co., 193 F.3d 742, 746 (3d Cir. 1999). The court explained:

> Safeguard Scientifics holds that the insured should not be dependent on the underlying plaintiff's pleading on state of mind, which may be inept. When a complaint alleges intentional misconduct (which insurance policies exclude from coverage) but might be amended to allege some other state of mind that would both trigger coverage and show liability, then the complaint should be treated as setting forth facts that potentially justify coverage. See Safeguard Scientifics, 766 F. Supp. at 329-30. This rule reflects the way that the complaint will actually be treated in the courts during the underlying litigation.

Frog, 193 F.3d at 746, n.2.

The Safeguard Scientifics approach is entirely consistent with Pennsylvania's requirement that a court confine itself to the four corners of the complaint, provided that the facts that are alleged on the face of the complaint comprehend an injury which is actually or potentially covered. The holding in Gene's Restaurant is also consistent with this approach inasmuch as the *conduct* alleged in the complaint, "striking with fists, violently shaking, casting about and repeatedly throwing to the ground," could not possibly permit an amended, or inclusive claim, of negligence.

In the underlying Florida action, the counterclaim stated that at the relevant time, 1) LD Learning owned certain valid copyright registrations; that Paladin, inter alia, made copies of the entire works without the permission or consent of LD Learning; and, that that was done with knowledge that the copyrights were owned by LD Learning, and was therefore willful. Under law, the facts that LD Learning owned the copyright registrations and that Paladin made copies of the entire works without LD Learning's permission, stated a claim for the innocent tort of copyright infringement. Thus, basic copyright infringement is so fundamentally grounded in the counterclaim, that even if the counterclaimants were not successful in proving willfulness, a court could award damages for non-willful infringement. "[A] pleader's overstatements, hyperbole or other vagrancies do not control whether an insured is entitled to a defense." Safeguard Scientifics, 766 F. Supp. at 330; Germantown Ins. Co. v. Martin, 595 A.2d 1172, 1175 (Pa. Super. 1991), appeal denied, 612 A.2d 985 (Pa. 1992). Moreover, bare assertion of knowledge or willfulness merely state a conclusion of law. The counterclaim in the Florida action does not set forth facts from which a court could find that Nobel's infringement, if any,

had to be willful.[2]

b. Exclusions

TIG next argues that the alleged claim is subject to a policy exclusion for advertising injury whose first publication takes place before the beginning of the policy period. Nobel points out, however, that the counterclaim states only that the alleged infringement took place within the last three years. "Where an insurer seeks to disclaim coverage under an insurance policy by invoking an exclusionary provision, it is the insurer which bears the burden of proving that the exclusion is applicable to the particular case." Federal Ins. Co. v. General Mach. Corp., 699 F. Supp. 490 (E.D. Pa. 1988) (citing Daburlos v. Commercial Ins. Co., 521 F.2d 18 (3d Cir.1975)). It is onlywhere the existence of facts constituting such an affirmative defense is admitted by the insured, or is established by uncontradicted testimony in the insured's case, that such a burden is removed from the insurer. Peters Township School Dist. v Hartford Acci. & Indem. Co., 833 F.2d 32 (3d Cir. 1987); Compagnie Des Bauxites De Guinee v. Insurance Co. of North America, 554 F. Supp. 1075 (W.D. Pa. 1983). Where an insurer cannot satisfy its burden, Pennsylvania law establishes that not only must insurance policies be construed in favor of the insured, but "policies must be construed 'in a manner which is more favorable to coverage.' " Imperial Casualty and Indemnity Co. v. High Concrete Structures, Inc., 858 F.2d 128, 131, n.4 (3d Cir.1988) (citing Houghton v. American Guar. Life Ins. Co., 692 F.2d 289, 291 (3d Cir.1982)). Since TIG cannot prove that the first allegedly infringing publication took place before the start

[2]This is particularly so, when one considers that Nobel's factual assertion made in its declaratory action, to the effect that its use of the materials was permitted by reason of the purchase of Levy company assets. A counterclaim which is premised on the same transaction as that alleged in the complaint, logically, responds to and incorporates by reference the factual averments of a complaint, while asking the court to reach a different legal conclusion.

of the policy period, this exclusion did not relieve TIG of its duty to defend.

Finally, TIG argues that there is an applicable exclusion for advertising injury that arises out of a breach of contract. The court assumes TIG's reference is to the "Sales Contract" and "Operating Agreement" between Dr. Levy and Paladin described in the Amended Counterclaim, whereby DRC's assets were transferred to Nobel, but assertedly, the copyrights which became the subject of the counterclaim were not.

The test for distinguishing between claims that sound in tort and claims that sound in contract, for the purposes of insurance coverage, was articulated in Redevelopment Authority of Cambria County v. International Ins. Co., 685 A.2d 581 (Pa. Super. 1996). The Redevelopment Authority had entered into a contract with a municipality in which the Redevelopment Authority supervised improvements to the municipal water system. Id. at 583. In an underlying state court action, the municipality alleged that the Redevelopment Authority "had failed to 'properly perform' the duties it had assumed under the contract, had been negligent, and had been unjustly enriched as a result of the retention of the monies paid to it to administer the project." Id. at 584. The trial court explained that "to be construed as a tort action, the wrong ascribed to the defendant must be the gist of the action with the contract being collateral." Id. (quoting Phico Insurance Co. v. Presbyterian Medical Services Corp., 663 A.2d 753, 757 (Pa. Super. 1995)). "The important difference between contract and tort actions is that the latter lie from the breach of duties imposed as a matter of social policy while the former lie for the breach of duties imposed by mutual consensus." Id. Finding that the claim arose exclusively out of the contractual relationship, the court held that the insurer was not obligated to defend. Id.

Similarly, in Keystone Filler & Mfg. Co., Inc. v. American Mining Ins. Co., 179 F. Supp.2d 432 (M.D. Pa. 2002), the court applied the Redevelopment Authority test and found that

where a company had manufactured a carbon-based product that did not meet the contractor's specifications, the manufacturer "was under no duty imposed by social policy to make the Mineral Black 123 a certain size." Keystone, 179 F. Supp.2d at 443. Since the manufacturer had breached a duty imposed only by mutual consensus, the insurer was under no obligation to defend. Id.

Moreover, in the context of insurance policies, courts have held that the term "arising out of" is construed strictly against the insurer and "means causally connected with, not proximately caused by." Roman Mosaic & Tile Co. v. Aetna Cas. & Sur. Co., 704 A.2d 665 (Pa. Super. 1997); see Erie Ins. Exchange v. Eisenhuth, 451 A.2d 1024, 1025 (Pa. Super. 1982) (citing Manufacturers Casualty Ins. Co. v. Goodville Mutual Casualty Co., 403 Pa. 603, 170 A.2d 571 (1961)). The phrase "arising out of" has been equated with "but for" causation. Id.; see McCabe v. Old Republic Ins. Co., 228 A.2d 901, 903 (Pa. 1967) ("arising out of," as used in policy exclusions, is unambiguous and indicates a "but for" or "cause and result" relationship).

Unlike the claims in Redevelopment Authority and Keystone, the counterclaim in the instant case encompasses liability which the law imposes upon all insureds for their tortious conduct. Because it cannot be said that the claim would not have arisen "but for" the contractual relationship, the contract in place between the parties to the Florida action was collateral and copyright infringement was the "gist" of the counterclaim.

3. TIG Insurance: Count III

In Count III, plaintiff seeks declaratory judgment against all defendants arguing that there is no coverage under the TIG policy because there is an applicable exclusion for "employment related practices."

The relevant exclusion precludes coverage for personal injury "arising out of" any

"refusal to employ", "termination of employment", "[c]oercion, demotion, evaluation, reassignment, discipline, defamation, harassment, humiliation, discrimination or other employment-related practices, policies, acts or omissions." (Endorsement modifying General Policy, Section I, Coverage B). Since the court has already determined that the counterclaimants in the Florida action alleged a claim of copyright infringement independent of any contractual liability arising out of Dr. Levy's employment agreement with Nobel, the alleged infringement did not "arise out of" an "employment related practice" as defined by the policy. The exclusion does not apply.

4. TIG Insurance: Count IV

In Count IV, TIG seeks declaratory judgment against all defendants arguing that the terms of the Umbrella Liability coverage in the TIG policy provide the same defenses to Nobel's claims against TIG in this action.

"An excess umbrella policy is generally designed to provide coverage in excess of the insured's policy with a primary insurer, but only if the underlying insurer covers the claim." I.C.D. Indus., Inc. v. Federal Ins. Co., 879 F. Supp. 480 (E.D. Pa. 1995) (citing 8A John A. Appleman & Jean Appleman, Insurance Law and Practice § 4909.85 (1981)). "If the insured's claim does not fall within the purview of the underlying policy, the excess umbrella policy serves as the primary insurance coverage for all claims within the excess umbrella policy's terms." Id.

In this case, TIG correctly represents that the terms of the umbrella policy issued to Nobel provide the same defenses to Nobel's claims as does the underlying insurance policy. See First Amend. Compl. for Declaratory Judgment, Attachment A, "Umbrella" Section. However, because the court has already determined that those defenses are unavailing under the primary

policy, they are equally unavailing here.

5. TIG Insurance: Count V

In Count V, TIG asserts that the policy provides indemnity only for sums which the insureds are legally obligated to pay as damages. The Settlement agreement provides, at section 7.4 and 7.5, that Nobel's payment of $185,000 to the counterclaimants was "in consideration for the transfer pursuant to this Section 7." Section 7 of the settlement agreement is entitled "Transfer of All of the Assets of LDLearning.com and Other Intellectual Property." The settlement agreement further states that the $185,000 payment to the counterclaimants was in the way of a non-interest bearing promissory note with twelve quarterly payments of principal of $15,416.67 each. Thus, TIG argues that because Nobel received a specific benefit, in the form of assignment of rights and copyrights, in exchange for the $185,000 payment, this payment is separate and distinct from a release of claims arising from the allegations of copyright infringement. As such, the sums paid in accord with Section 7 of the settlement agreement do not constitute "damages" which Nobel was "legally obligated to pay."

Unless a settlement is somehow unacceptable, an insurer must compensate the insured. American Intern. Underwriters Corp. v. Zurn Industries, Inc., 771 F. Supp. 690, 701 (W.D. Pa. 1991). To determine that a settlement is acceptable, the court must "satisfy [itself] that the negotiations were 'done in good faith and the settlement was fair and reasonable.' " Id. (quoting Alfiero v. Burks Mut. Leasing Co., 500 A.2d 169, 172 (Pa. Super 1985)). An insurer's "failure to join in the settlement proceedings and their refusal to indemnify [the insured] . . . [has] the effect of relaxing judicial scrutiny of the settlement, limiting it to a search for reasonableness. Id. When an insurer refuses to defend and an insured settles, "[i]n order to recover the amount of the settlement from the insurer, the insured need not establish actual liability to the party with whom

it has settled so long as a potential liability on the facts known to the insured is shown to exist, culminating in a settlement in an amount reasonable in view of the size of possible recovery and degree of probability of claimant's success against the insured." American Intern., 771 F. Supp. at 702 (citing Luria Bros. & Co., Inc. v. Alliance Assur. Co., Ltd., 780 F.2d 1082, 1091 (2d Cir. 1986)). Thus, when an insurer declines coverage and refuses to negotiate on the grounds that the matter is not covered by the policy, it does so at its own peril. Id. If it is determined that the insurer is obligated to indemnify for the incidents in question, the insurer must usually accept the apportionment arrived at in the negotiations it rebuffed. Id.

However, in Zurich Ins. Co. (U.S. Branch) v. Killer Music, Inc., 998 F.2d 674, 679 (9th Cir. 1993), the court "recognize[d] that the settlement agreement represent[ed], in part, an exchange of cash consideration for the rights to [certain] songs, not simply compensation for damages from copyright infringement." Noting that the insurer "had no control over the terms of the settlement agreement, which was structured so that [the insured] received the rights to the songs," the court explained that "[w]hen the issue of the amount of a reasonable settlement in good faith is addressed," the insurer has "the opportunity to demonstrate that some portion, if not all, of the settlement amount is allocable to the value of the songs which [the insured] received in the settlement agreement." Id. at 679-80.

In the instant case, although the settlement agreement in the Florida action undoubtedly obligated Nobel to pay $185,000, the extent to which this sum reflects damages flowing from the covered counterclaim is unclear. A hearing will be necessary to determine whether the settlement was in good faith and the allocation reasonable.

6. TIG Insurance: Count VI

In Count VI, plaintiff asserts that 1) the Policy does not cover attorney's fees and costs

incurred by Nobel in the affirmative prosecution of the Florida action; 2) the nature of the relief sought in the counterclaim precludes equitable apportionment of attorney's fees and costs between the affirmative prosecution of the action and the defense of the counterclaim; and, 3) TIG is entitled to offset any obligation to Nobel for defense costs by the $175,000 for legal costs paid to Nobel by the counterclaimants under the terms of the settlement agreement.

The court notes at the outset that counsel fees for a breach of the duty to defend can only be awarded from the time when the duty to defend arose. Heffernan & Co. v. Hartford Ins. Co. of America, 614 A.2d 295 (Pa. Super. 1992). Thus, it is clear that since TIG's duty arose, for the first time, when the counterclaimants in the Florida action alleged copyright infringement by Nobel, any award of attorney's fees and costs could not encompass any sums expended by Nobel in the affirmative prosecution of the Florida action before the filing of the Amended Counterclaim on October 20, 2001.

On the issue of apportioning defense costs with regard to affirmative prosecution costs after October 20, 2001, Nobel takes the position that the affirmative claims and the counterclaims were "inextricably intertwined," and the pursuit of the affirmative claims was "necessary to the defense of the litigation as a strategic matter." Thus, Nobel argues that TIG is liable for both. The court agrees. The typical recovery for breaching the duty to defend is to require the breaching insurer to pay for the costs of defense. Based on the usual contract rule for determining damages, the recovery will be the cost of hiring substitute counsel and other costs of the defense of the underlying action between the injured party and the insured. American Contract Bridge League v. Nationwide Mut. Fire Ins. Co., 752 F.2d 71 (3d Cir. 1985); Carpenter v. Federal Ins. Co., 637 A.2d 1008 (Pa. Super. 1994), appeal granted, 655 A.2d 508 (Pa. 1995) and appeal dismissed, 677 A.2d 836 (Pa. 1996); F.B. Washburn Candy Corp. v. Fireman's Fund,

541 A.2d 771 (Pa. Super. 1988).

In Safeguard Scientifics, infra, the court, having found that a claim in the underlying suit was potentially covered and that the insurer thus had a duty to defend the entire claim, went on to observe that the insurer "ha[d] pointed to no case law suggesting that an insurance company's obligation does not extend to the litigation of counterclaims raised in the same lawsuit." Safeguard Scientifics, 766 F. Supp. at 333. Acknowledging that the counterclaims were not compulsory, the court nonetheless held that "the pursuit of the counterclaims was inextricably intertwined with the defense . . . and was necessary to the defense of the litigation as a strategic matter." Id. at 333-34. Thus, the court held that the insurer's duty to defend extended to the counterclaims raised in the same proceeding. Id.

Although few courts have addressed the issue of an insurer's liability for affirmative claims by the insured, the courts that have found liability have done so where the claims were "part of the same dispute" and could "defeat or offset liability," Id. at 333-34; Citadel Holding Corp. v. Roven, 603 A.2d 818, 824 (Del.1992).

The court agrees with and follows Safeguard Scientifics. Although prior to the filing of the counterclaim TIG had no duty to defend, once copyright infringement was alleged against Nobel in the Florida action, Nobel's affirmative claims became critical to and "inextricably intertwined" with the defense of the copyright infringement claim. As the prosecution of the affirmative claims was essential to the defense against the counterclaim, it was logically encompassed by TIG's duty to defend Nobel.[3]

---

[3]Nobel's Complaint for Declaratory Judgment in the Florida action contained the following: Count I: Copyright Infringement in and to the *Stop and Go* book and *Spotlight* book; Count II: Copyright Infringement in and to the *Sauditory Memory* books; Count III: Copyright Infringement in and to the *New Image* book; Count IV: Copyright Infringement in and to the

Finally, it is fundamental that the principle of indemnity "prohibits insurance contracts from conferring a benefit greater than the insured's loss (i.e., a "double recovery")" and thus, an insurer who has recovered part of its loss from one source, cannot recover an amount equal to its entire loss from another. Koppers Co., Inc. v. Aetna Cas. and Sur. Co., 98 F.3d 1440 (3d Cir. 1996) (citing J.H. France, 626 A.2d at 508) (stating principle that insured "cannot collect more than it owes in damages")). Therefore, TIG is entitled to offset its obligation to Nobel by the $175,000 that Nobel received from the counterclaimants. Although the settlement agreement states, in pertinent part, that the $175,000 was paid to Nobel "to compensate them for a portion of their legal fees incurred in connection with the *prosecution of its claims* . . . in connection with the Litigation," (Exhibit D, First Amend. Compl. at 4) (emphasis added), because the court has determined that TIG is liable for the prosecution of the affirmative claims as of October 20, 2001, TIG is entitled to the setoff to the extent of $175,000 against Nobel's post-counterclaim fees, costs and expenses.

7. TIG Insurance: Count VII

In Count VI, plaintiff asserts that there is no coverage for punitive damages or other fines and penalties under the TIG policy, as a matter of public policy, and as a matter of law. Therefore, to the extent that any amounts paid by Nobel were paid in satisfaction of claims for punitive damages, fines or penalties set forth in the counterclaim, TIG is not required to reimburse Nobel. The court agrees.

Visual Tracking books; Count V:Breach of Organization Agreement; Count VI: Violation of Florida's Deceptive and Unfair Trade Practices Act; Count VII: Unfair Competition under Florida Law; Count VIII: Fraud; Count IX: Injunctive Relief for Breach of Employment Agreement; Count X: Civil Conspiracy; and, Count XI: Injunctive Relief for Breach of Agreement of Operations.

In Pennsylvania, insurance is meant to cover only fortuitous losses and should not cover against wrongful acts. Koppers Co., Inc. v. Aetna Cas. and Sur. Co., 98 F.3d 1440, 1447 (3d Cir. 1996); United Services Auto. Ass'n v. Elitzky, 517 A.2d 982, 986 (Pa. 1986). The function of punitive damages is to deter, and punish, egregious behavior. G.J.D. by G.J.D. v. Johnson, 713 A.2d 1127, 1129 (Pa. 1998). A claim for punitive damages against a tortfeasor who is personally guilty of outrageous and wanton misconduct is excluded from insurance coverage as a matter of law. Butterfield v. Giuntoli, 670 A.2d 646, 654-55 (Pa. Super. 1995)(noting exception for punitive damages awarded on the basis of vicarious liability). Because punitive damage awards are designed to punish an individual litigant for misconduct, such awards are not bodily injury or property damage awards and an insurer owes no duty to indemnify an insured on such an award. Creed v. Allstate Ins. Co., 529 A.2d 10, 12 (Pa. Super. 1987). Pennsylvania courts have reasoned that to permit insurance against the sanction of punitive damages would be to permit such offenders to purchase a freedom of misconduct altogether inconsistent with the theory of civil punishment that such damages represent. Esmond v. Liscio, 224 A.2d 793, 799 (Pa. 1966). Therefore, under Pennsylvania law, TIG has no duty to indemnify its insured to the extent that any amounts paid by Nobel were paid in satisfaction of claims for punitive damages, fines or penalties set forth in the counterclaim.

8. Nobel Counterclaim Count I: Breach of Contract (Costs of Entire Defense)

In Counterclaim Count I, Nobel argues that TIG breached its contractual duty to defend its insured in an action stating a claim which could potentially fall within the coverage of the policy and is therefore liable for all defense costs up to the date of settlement plus interest. The court agrees.

Addressed implicitly throughout this opinion, Pennsylvania applies the rule that where a

single potentially covered claim is alleged, the insurer incurs an obligation initially to defend the entire action. Bracciale v. Nationwide Mut. Fire Ins. Co.,1993 WL 323594, *5 (E.D. Pa. 1993) (citing Safeguard Scientifics, 766 F. Supp. at 324); D'Auria, 507 A.2d at 859. Thus, an insurer who refuses to defend becomes liable for the costs incurred in securing an alternative defense against all of the claims in the underlying complaint even where, as here, it is clear at the outset that the underlying action asserted some non-covered claims. American Contract Bridge League v. Nationwide Mut. Fire Ins. Co., 752 F.2d 71, 75 (3d Cir. 1985).

In American Contract, the parties agreed that certain antitrust claims alleged against the insured were outside the policy coverage and the third circuit acknowledged that "[c]learly the [underlying] complaint . . . contain[ed] certain allegations . . . not covered by the [insurance] policy." Id. When the insured settled the underlying action, the court explicitly rejected, however, the insurer's argument that even if it was liable for the defense of certain other claims, it had no liability for the defense of the antitrust claims. Nationwide emphasized that "[u]nder Pennsylvania law, . . . once a third party has raised allegations against an insured, which potentially fall within the coverage provided, the insurer is obligated to *fully* defend its insured until it can confine the possibility of recovery to claims outside the coverage of the policy, Id. (emphasis added) (citing Cadwallader, 152 A.2d at 488; Lee v. Aetna Casualty & Surety Co., 178 F.2d 750, 753 (2d Cir.1949)). Like the insurer in Nationwide, by virtue of its refusal to defend, TIG became liable to its insured for the costs incurred in securing an alternative defense against all claims in the underlying complaint, plus interest.

9. Nobel Counterclaim Count II: Breach of Contract (Settlement Costs)

In Counterclaim Count II, Nobel argues that TIG breached its duty to defend its insured

and is therefore obligated under the policy to pay all costs for covered claims that Nobel and Paladin became "legally obligated to pay as damages," i.e., $185,000, plus interest. This issue was resolved in the court's analysis under No. 5, supra, of Count V of the complaint. A hearing is needed to determine whether the settlement was in good faith and the allocation reasonable. l.

10. Nobel Counterclaim Count III: Estoppel (Settlement Costs)

In Counterclaim Count III, Nobel asserts that although an insurer's duty to indemnify is usually triggered only where the claim is *actually* covered, an insurer who has a duty to defend and refuses to do so, is estopped from arguing that the settlement represents claims outside those covered under the policy and thus TIG is required to reimburse Nobel for the settlement achieved.

In Pacific Indem. Co. v. Linn, 766 F.2d 754, 766 (3d Cir.1985), the third circuit affirmed the district court's holding that where a matter implicating the duty to indemnify is terminated by settlement rather than final judgment, "the duty to indemnify necessarily had to follow the duty to defend because settlement made it impossible to determine on what theories of liability, if any, the underlying claimants would have prevailed." Based on the holding of Pacific Indemnity, the district court in Princeton Ins. Co. v. LaHoda, 1996 WL 11353, *5 (E.D. Pa. 1996), held that an insurer who breaches its obligation to defend is estopped from arguing that the settlement represented claims outside those covered under the policy because an insurer "cannot stand aside while the underlying case proceeds and only after it is settled seek to dissect it."

In Cooper Labs., Inc. v. International Surplus Lines Ins. Co., 802 F.2d 667, 674 (3d Cir. 1986) (applying New Jersey law), however, the third circuit clarified the holding in Pacific Indem. and found it inapplicable where, as here, the insured, rather than the insurance company, settled the case:

> In [Pacific Indem.], the district court had directed various insurance companies to defend cases brought against their insured even though that litigation included some claims which were not within the policies' coverage. When cases were later settled by the insurance carriers, the court refused to attempt allocation of indemnity and simply made it correspond to the duty to defend. In that instance, this court noted that by settling without an agreement with the insured, the carrier conceivably could foreclose any right of indemnification by the insured. Here, by contrast, the insured settled the case so it is not exposed to the risk that influenced the [Pacific Indem.] decision.

Cooper Labs, 802 F.2d at 674; see 12th Street Gym, Inc. v. General Star Indem. Co., 93 F.3d 1158 (3d Cir. 1996) (applying Pennsylvania law) (reaffirming the holding in Coopers Labs.). Coopers Labs is consistent with the well-established rule that, as in any breach of contract action, the insured has the burden of proving damages with reasonable certainty. Safeguard Scientifics, 766 F. Supp. at 334-35; see International Communication Material Inc. v. Employer's Ins. of Wausau**,** 1996 WL 1044552 (W.D. Pa. 1996) ("[the insured] must bear the burden of apportioning the settlement payment between covered and noncovered damages.").

11. Nobel Counterclaim Count IV: Declaratory Judgment (Defense, Settlement and Prosecution Costs)

In Counterclaim Count IV, Nobel seeks declaratory judgment in its favor and against TIG as to TIG's liability for all of Nobel's defense, settlement and prosecution costs in the Florida action as well as for the costs of defending TIG's instant complaint for declaratory judgment. The first three issues have already been disposed of.

As to the fourth, state rules concerning the award of attorneys' fees are to be applied in diversity cases whether these rules provide for an award or deny it, provided such rules do not run counter to federal statutes or policy considerations. Montgomery Ward & Co., Inc. v. Pacific Indem. Co., 557 F.2d 51, 56 -57 (3d Cir. 1977) (citing Tryforos v. Icarian Development

Company, S. A., 518 F.2d 1258, 1265 (7th Cir. 1975), cert. denied, 423 U.S. 1091 (1976). Pennsylvania courts adhere to a close application of the American Rule, which precludes the award of attorneys' fees. Montgomery Ward, 557 F.2d at 58 -59 (citing Corace v. Balint, 210 A.2d 882 (Pa. 1965)). However, Pennsylvania has permitted the imposition of attorneys' fees on the offending party as a part of the fine imposed in civil contempt proceedings where contumacious or obdurate conduct has been involved. Id. (citing Bata v. Central-Penn National Bank of Philadelphia, 293 A.2d 343, 352-53 n.13 (Pa. 1972); Brocker v. Brocker, 241 A.2d 336, 339 (Pa. 1968); Lichtenstein v. Lichtenstein, 481 F.2d 682, 684 (3d Cir. 1973).

Based on the holdings in Bata and Brocker, the third circuit predicted that the Pennsylvania Supreme Court would apply the "obdurate behavior" exception to the American rule and permit recovery of attorney's fees based on "bad faith and obdurate conduct." Montgomery Ward, 557 F.2d at 59 & n.13. Alternatively, the court stated, there was reason to expect that the Pennsylvania courts "would allow recovery of attorneys' fees . . . as a matter of public policy in order to prevent insurers from frustrating the contractual rights of the insured . . . when the refusal to defend was unreasonable and in bad faith. Id. at 60.

Pennsylvania intermediate appellate courts have followed this approach. See e.g., Carpenter v. Federal Ins. Co., 637 A.2d 1008 (Pa. Super. 1994); First Pennsylvania Bank, N.A. v. National Union Fire Ins. Co. of Pittsburgh, Pa., 580 A.2d 799 (Pa. Super. 1990); Kelmo Enterprises v. Commercial Union Ins. Co., 426 A.2d 680 (Pa. Super. 1981). To support a finding of bad faith, the insurer's conduct must be such as to import a dishonest purpose, and it must be shown that the insurer breached a known duty, such as good faith and fair dealing, through some motive of self interest or ill will. Bonenberger v. Nationwide Mut. Ins. Co., 791 A.2d 378 (Pa. Super. 2002). Since Nobel has not alleged that TIG's refusal to defend was in bad faith, Nobel is

not entitled to recover the costs of defending this action.

IV. CONCLUSION

For the foregoing reasons, TIG's request for declaratory judgment is granted, in part and denied in part; and, Nobel's counterclaim for declaratory judgment is also granted, in part and denied in part. An appropriate order follows.